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SUBJECT: CROSS-STRAIT ECONOMICS - SIGNALING MORE OPENING TO PRC

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1C. TAIPEI 1386

Classified By: AIT Director Stephen M. Young, Reason 1.4 b/d

Summary

11. (C) Taiwan announced April 27 that it would permit investment in the PRC in semiconductor packaging and testing and small-size TFT-LCD manufacturing. These two measures mark what may be the most significant cross-Straight liberalization measures of President Chen Shui-bian's second term. Taiwan also revealed this week that it would expand the mini-links that connect Taiwan-controlled Kinmen and Matsu islands directly to the Mainland and might liberalize Renminbi (RMB)-New Taiwan Dollar (NTD) currency exchange unilaterally. Taken together these four initiatives signal a somewhat more positive approach toward cross-Straight economic relations, suggesting the possibility of further progress on cross-Straight economic liberalization. End summary.

Long Awaited Investment Announcements

12. (SBU) Mainland Affairs Council Chairman Joseph Wu announced April 27 that Taiwan will permit investment in the PRC in semiconductor packaging and testing and the manufacture of small-size TFT-LCD panels. The announcement marks what may be the most significant cross-Straight liberalization measures of Chen's second term. It was the first time that Taiwan had approved a new sensitive category of PRC investment since it released regulations for semiconductor manufacturing investment in March 2002. Semiconductor packaging and testing firms and TFT-LCD manufacturers have been seeking these changes for several years. Wu had previously indicated that the TFT-LCD announcement was in the works in his meeting with the AIT Director on April 18 (ref C).

Critical Opening for Packaging and Testing

13. (C) The announcement was especially important to the competitiveness of Taiwan's semiconductor packaging and

testing firms. Taiwan leads the global packaging and testing industry with five of the world's top ten firms, including number one Advanced Semiconductor Engineering (ASE) and number three Siliconware Precision Industries Limited (SPIL) (ref A). Many Taiwan firms have already developed detailed plans for investment in the Mainland. ASE Chief Financial Officer Freddy Liu told AIT last year that ASE had already leased land in the PRC for a packaging and testing facility in anticipation of such an announcement. The new opening limits investment to less advanced packaging and testing technologies, and some observers have complained that the definition of permitted technologies needs to be clarified. Taiwan firms will continue to seek liberalization of more advanced technologies. However, they will now have better chance to compete in the rapidly growing Mainland semiconductor market before emerging PRC firms become major challengers.

TFT-LCD, Less Urgency

¶4. (SBU) The move to open small-size TFT-LCD manufacturing was made in part to let Taiwan's Toppoly Optoelectronics proceed with the acquisition of Philips' display unit in the PRC. Most Taiwan TFT-LCD manufacturers already have facilities in the PRC that take TFT-LCD panels produced in Taiwan and assemble them into modules that are then used as the major component in televisions and monitors. However, there is less urgency among the firms to begin large scale panel manufacturing investment in the PRC. Because TFT-LCD panel manufacturing is highly capital intensive the PRC investment environment is not as attractive as it is for other industries. The upstream supply chain in the PRC is

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not as fully developed as it is in Taiwan, where, for example, Corning has invested US\$ 1.5 billion in Taichung to produce glass for TFT-LCD manufacturers. In addition, Taiwan's major competitors, Korea's Samsung and LG Philips, have not invested heavily in PRC manufacturing facilities. Nevertheless, some Taiwan firms will take advantage of the new opening to move aging facilities to the PRC. As the supply chain in the PRC develops, more firms will follow.

"Effective Opening" - This Week's Leitmotif

¶5. (U) Taiwan announced two other important cross-Straits economic measures this week. On April 25, Premier Su Tseng-chang said Taiwan will expand the mini-links that

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connect Taiwan-controlled Kinmen and Matsu islands directly to the Mainland by adding a Kinmen-Quanzhou ferry route beginning in June. Taiwan will also permit all registered residents of Kinmen and Matsu now living elsewhere in Taiwan to travel to the PRC via the mini-links. On the same day, MAC Chief Secretary Jan Jyh-horng announced that Taiwan may unilaterally permit RMB-NTD exchange at certain tourist destinations in Taiwan even if the two sides cannot reach an agreement on currency settlement. Currently, RMB-NTD exchange is permitted only in Kinmen and Matsu.

¶6. (SBU) The mini-links expansion and currency exchange proposal will not have a major economic impact. In addition, Jan's statement on the currency exchange proposal was non-committal, and he reiterated that Taiwan's priority is to negotiate a settlement mechanism. However, the currency exchange proposal is significant because it represents a step back from the Chen Administration's earlier insistence that Taiwan and the PRC must enter into a currency settlement agreement before the Kinmen-Matsu exchange pilot program could be expanded.

Comment - Signs of a More Positive Approach

¶7. (C) These new initiatives marked the first concrete signs that there would be any significant opening in the "active management, effective opening" policy announced by President Chen on January 1 (ref B). Taken together with MAC Chairman Wu's April 12 statement that Taiwan might further open Taiwan to PRC tourists unilaterally, Taiwan is signaling a relatively more positive approach to economic relations with the PRC. The packaging and testing and TFT-LCD investment announcements show that the new approach extends to politically sensitive areas like technology transfer. The statements on unilateral moves on tourism and currency exchange suggest that compromises may be possible even on some initiatives previously blocked over sovereignty issues. In agreeing to some positive cross-Straight steps, Chen probably hopes to mollify critics from his own party and the business community and to counter the political fallout from the recent KMT-CCP economic forum in Beijing, whose participants included some businesses that have supported the DPP. The government's new approach may create a window of opportunity for further progress on cross-Straight economic liberalization. However, given Taiwan's contentious and volatile political situation, it is unclear how long this new approach will last. For at least some of the current administration's sharpest critics, only full opening to the PRC, including unlimited air links, would truly satisfy. That still seems unlikely under current political conditions. End comment.

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